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BASE EROSION AND PROFIT SHIFTING: HOW CORPORATIONS USE TRANSFER PRICING TO AVOID TAXATION

GREGORY PUN*

Abstract: In an increasingly global economy, base erosion and profit shifting (BEPS) has allowed multinational corporations to utilize their subsidiaries to move assets and profits. As a result, corporations are able to lower their tax bills, but also deprive governments of integral tax funds, while leaving smaller competitors who pay their fair share of taxes at a disadvantage. To combat the effects of BEPS, the Organization for Economic Cooperation and Development (OECD) has collaborated with the Group of 20 (G20) major economies for the first time to implement an action plan. The BEPS Project seeks to ensure all corporations pay proper taxes to the government of each country in which they operate by addressing issues presented by transfer pricing and profit reporting. As the plan has been developed by the world's major economies, difficulties arise for developing countries that may not have the resources to implement the plan successfully. Attempts to implement a universal rule face further difficulties given that an array of treaties addressing these issues already exist. To ease the transition, the BEPS Project utilizes safe harbors—sacrificing equity for efficiency in many instances. While the collaborative effort represents a major step forward, and the creation of the plan and first efforts to implement it are certainly beneficial, there is still a lot of work to be done. Questions remain regarding how to properly address BEPS and create a universally fair system for economies and corporations of all sizes.

INTRODUCTION

In 2013, the Organisation for Economic Cooperation and Development (OECD), in collaboration with the Group of 20 (G20) major economies, put forward a plan of action to combat base erosion and profit shifting (BEPS).[1] In

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[1] *About BEPS and the Inclusive Framework*, OECD, http://www.oecd.org/ctp/beps-about.htm [https://perma.cc/M9KH-4C64]. The Organisation for Economic Cooperation and Development (OECD) was founded in 1960 by the United States, Canada, and eighteen European countries to facilitate economic development. *Members and Partners,* OECD, http://www.oecd.org/about/membersandpartners/ [https://perma.cc/CRP3-RGDD]. The OECD currently consists of thirty-five member countries, including many of the world's largest economies, and a number of emerging countries. *Id.* The OECD works closely with emerging economies and developing countries in order to foster and encourage economic development. *Id.* The Group of 20 (G20) nations is composed of nineteen of the world's largest economies—including China, Russia, and India—and the European Union, whose finance ministers and central bank governors meet biannually. Kimberly Amadeo, *What Does the G20*

2016, the OECD and a number of participants took action by establishing the first legislative and administrative efforts of the BEPS Project.[2] In layman's terms, BEPS refers to the negative effects of multinational companies' efforts to avoid taxation by moving profits to low or no-tax locations.[3] The goal of the OECD and G20 nations—working on equal footing for the first time—is to reinforce the integrity of the global tax system.[4]

Multinational companies operate certain portions of their business in different countries, and strategically handle their business between countries in order to reduce their tax bill.[5] Corporations exploit mismatches between nations where they conduct businesses in order to generate benefits from double non-taxation.[6] Corporations also utilize the digital economy to sell goods in places where they have no physical presence, which often means profits from such sales are not taxed in that country.[7] The OECD has begun to address these issues through the BEPS Project to ensure corporations are paying their fair share of taxes.[8] While BEPS issues go beyond those created by transfer pricing, transfer pricing has been a central component of the discussion on how to address BEPS.[9]

Corporations often exploit transfer pricing laws in order to create tax benefits.[10] Multinational corporations accomplish this by reporting profits to entities in tax havens that do not correspond with the actual activities by those entities.[11] This allows those multinational corporations to evade the higher tax bill they would have received if they had reported profits in the higher tax jurisdictions where they actually occurred.[12] Corporations that are vertically integrated are much less likely to participate in arm's length transactions; rather,

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Do?, BALANCE (Mar. 23, 2017), https://www.thebalance.com/what-is-the-g20-3306114 [https://perma.cc/6AJ2-FWDZ]. The group was formed in 1999 with the purpose of discussing and addressing the key issues affecting the global economy. *Id.*

[2] *See* ERNST & YOUNG, THE LATEST ON BEPS—2016 MID-YEAR REVIEW 14–15 (2016), http://www.ey.com/Publication/vwLUAssets/EY-the-latest-on-beps-2016-mid-year-review/$FILE/EY-the-latest-on-beps-2016-mid-year-review.pdf [https://perma.cc/YC6H-VTZE] (describing the opening of the Multilateral Component Authority Agreement and listing those jurisdictions that have signed on).

[3] *See About BEPS and the Inclusive Framework*, *supra* note 1.

[4] Patrick Love, *BEPS: Why You're Taxed More Than a Multinational*, OECD INSIGHTS (Feb. 13, 2013), http://oecdinsights.org/2013/02/13/beps-why-youre-taxed-more-than-a-multinational/ [https://perma.cc/Y3SK-YKWN].

[5] *See BEPS Explained,* ATEL, Oct.–Dec. 2014, at 9, 9, http://www.nxtbook.com/newpress/atel/le-magazine-du-tresorier/87-4T2014/#/8 [https://perma.cc/W7DB-B2AB].

[6] *Id.*

[7] *Id.*

[8] *See About BEPS and the Inclusive Framework*, *supra* note 1.

[9] *See BEPS Explained*, *supra* note 5, at 11.

[10] *See id.*

[11] *What is Transfer Pricing?*, WTP ADVISORS, http://wtpadvisors.com/tax-advisory/what-is-transfer-pricing [https://perma.cc/FYK2-W2Z9].

[12] *See id.*

they are more inclined to attempt to transfer goods between entities for below market value because they are controlling both sides of the transaction.[13] These corporations often report profits in tax havens that are significantly greater than what would be expected based on the work actually done there.[14] This allows corporations to avoid taxation in developed countries and instead pay the lighter tax bill wherever they choose to report their profits.[15] The OECD has directly addressed the issues created by transfer pricing in order to ensure proper taxation.[16] Actions 8, 9, and 10 of the BEPS Project are aimed at aligning transfer pricing outcomes with their respective value creation.[17] To do this, the use of intangibles, risks, capital, and other high-risk transactions intended to shift profits must be examined more closely.[18]

BEPS is hurting the global economy in a number of ways, including depriving nations of valuable income needed to jumpstart growth.[19] Further, the use of BEPS strategies creates a sense of distrust among citizens who may in turn question the overall fairness of the tax system.[20] Additionally, some researchers believe that the economic effects spread and cause a decline in employment, innovation, and productivity when post-tax profit becomes the main attractor for investment.[21]

This Note examines the issues created by base erosion and profit shifting. While a number of strategies exist to accomplish the goals of BEPS, this Note focuses on the exploitation of transfer pricing. Part I of this Note explains the strategies that multinational corporations use to avoid taxation through BEPS and the efforts the U.S. government is taking to prevent reliance on these strategies. Part II explains the legal issues presented by BEPS and the difficulty of enforcing the current rules. In Part III, this Note suggests that while the efforts put forth by the OECD and G20 nations will have a material impact by forcing multinational corporations to pay closer to their fair share of taxes, the proposed changes will face widespread challenges and will be unable to close all of the existing loopholes.

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[13] *See* Lee Sheppard, *Transfer Pricing as Tax Avoidance,* FORBES (June 25, 2010, 12:00 PM), http://www.forbes.com/2010/06/24/tax-finance-multinational-economics-opinions-columnists-lee-sheppard.html [https://perma.cc/P8LT-WXBT].

[14] *Id.*

[15] *See id.*

[16] *See* OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING 20 (2013), https://www.oecd.org/ctp/BEPSActionPlan.pdf [https://perma.cc/BM2X-P78Q] [hereinafter OECD, ACTION PLAN].

[17] *See id.*

[18] *See id.*

[19] *See OECD Presents Outputs of OECD/G20 BEPS Project for Discussion at G20 Finance Ministers Meeting*, OECD, http://www.oecd.org/tax/oecd-presents-outputs-of-oecd-g20-beps-project-for-discussion-at-g20-finance-ministers-meeting.htm [https://perma.cc/LDF5-YKAZ].

[20] *Id.*

[21] Love, *supra* note 4.

I. Background

A. The BEPS Plan

In 2013, the OECD began to collaborate with the G20 nations in order to address issues created by base erosion and profit shifting by multinational corporations.[22] The OECD is an intergovernmental economic organization consisting of thirty-five member countries working toward economic progress.[23] The G20 is the leading organization for international collaboration on economic issues.[24] The G20 consists of nineteen countries and the European Union with member economies responsible for eighty-six percent of global economic activity, seventy-eight percent of international trade, and two-thirds of the global population.[25] In 2016, the OECD and a limited number of participating countries began to finally put the first steps of the BEPS Project into action.[26]

B. What Is BEPS and How Is It Possible?

It is widely accepted that companies are able to strategically position their operations in order to lower their corporate tax bill.[27] It is estimated that anywhere between four and ten percent of corporate tax revenues are lost through these methods.[28] These estimates conservatively suggest that between one hundred and two hundred and forty billion dollars of corporate income tax revenues are being lost annually due to BEPS.[29] This is a particularly large problem for developing countries that rely heavily on corporate income tax for government funding.[30] To combat these massive losses, the G20 countries have coordinated with the OECD to create rules and regulations to ensure that companies are paying the right amount of taxes.[31]

One major strategy that corporations utilize to avoid taxation is transfer pricing.[32] To take advantage of transfer pricing, corporations allocate profits among their subsidiaries in different jurisdictions, acting as though the corpo-

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[22] *About BEPS and the Inclusive Framework*, *supra* note 1.

[23] *Who Does What*, OECD, http://www.oecd.org/about/whodoeswhat/ [https://perma.cc/LB5V-K5EU].

[24] *The G20,* AUSTL. GOV'T: DEP'T FOREIGN AFF. & TRADE, http://dfat.gov.au/international-relations/international-organisations/g20/pages/the-g20.aspx [https://perma.cc/KZ86-VHQJ].

[25] *Id.*

[26] *See* ERNST & YOUNG, *supra* note 2, at 14–15.

[27] *See About BEPS and the Inclusive Framework*, *supra* note 1.

[28] *See id.*

[29] *Id.*

[30] *Id.*

[31] *See id.* (explaining that the OECD and G20 countries have collaborated to create a fifteen-point base erosion and profit shifting (BEPS) action plan).

[32] *See* Patrick Love, *What Is BEPS and How Can You Stop It?*, OECD INSIGHTS (July 19, 2013), http://oecdinsights.org/2013/07/19/what-is-beps-how-can-you-stop-it/ [https://perma.cc/GMR3-Z2N2] (explaining the issues presented by BEPS and the role of transfer pricing).

rate affiliates are all separate economic actors engaging in arm's length transactions with one another.[33] While the principals of financial accounting treat the corporate group as one single entity, the laws of federal income taxation do not.[34] These laws treat a corporation and all of its subsidiaries as separate economic actors, which essentially allows multinational corporations to determine where they would like their profits to be taxed, or where they would like to allocate the profits to avoid taxation.[35]

Corporations utilize transfer pricing to report their profits in nations that are considered tax havens in order to avoid taxation in developed countries.[36] Manipulation often leads to profit reporting that does not align with actual value creation.[37] While this seems problematic from a taxation perspective, some academics argue that the use of transfer pricing and profit shifting is essential in supporting decentralization and coordination.[38] Transfer pricing encourages all of the entities of a multinational corporation to work together while spreading profits to lower tax jurisdictions.[39] Additionally, corporations claim being able to strategically avoid taxation is integral to remaining competitive in the market.[40] Corporations would not be able to keep up with competitors if they were forced to pay a larger tax bill while those competitors were able to avoid a number of taxes.[41] Despite these perceived advantages, the issues surrounding transfer pricing outweigh the benefits, as many corporations strategically work to avoid taxation in high tax jurisdictions and governments are denied essential funding.[42]

C. Can This Be Fixed?

While the issues created through transfer pricing have been observed for a number of years, efforts to curb the practice have been met with limited success.[43] Over the last decade, the U.S. government has brought multinational

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[33] Sheppard, *supra* note 13.

[34] *Id.*

[35] *Id.*

[36] *Id.*

[37] OECD, ALIGNING TRANSFER PRICING OUTCOMES WITH VALUE CREATION 9 (2015), http://www.oecd-ilibrary.org/docserver/download/2315351e.pdf?expires=1487538349&id=id&accname=guest&checksum=37D727ACB621B3DC5809B2E6BBD97C56 [https://perma.cc/J8DA-7FYC] [hereinafter OECD, ALIGNING TRANSFER PRICING OUTCOMES WITH VALUE CREATION].

[38] KENNETH KLASSEN, PETRO LISOWSKY & DEVAN MESCALL, TRANSFER PRICING: STRATEGIES, PRACTICES, AND TAX MINIMIZATION 91–92, https://www.irs.gov/pub/irs-soi/13rescontransferpricing.pdf [https://perma.cc/94TE-HRX3].

[39] *See id.*

[40] Sheppard, *supra* note 13.

[41] *See id.*

[42] *See id.*

[43] *See* Roger J. Jones et al., Altera*: Tax Court Invalidates Section 482 Regulation on Administrative Law Grounds*, MCDERMOTT WILL & EMERY (Aug. 19, 2015), http://www.mwe.com/Altera-Tax-

corporations to court multiple times, only to see its efforts fail.[44] In 2010, the U.S. Internal Revenue Service (IRS) announced its decision to create a new Director of Transfer Pricing position due to concerns about revenue loss through transfer pricing.[45] Ernst & Young has surveyed tax authorities since 1995 regarding the number of staff members they have dedicated to specific issues.[46] Following their 2012 survey, the accounting giant concluded that tax authorities have continuously hired additional staff members devoted specifically to the issue of transfer pricing.[47]

In 2013, the OECD displayed greater concerns about the impacts of transfer pricing and began to conduct research regarding the best plan to limit or eliminate BEPS.[48] The OECD has come up with actions to try to align the transfer pricing outcomes with value creation.[49] Three actions of the OECD's fifteen-part plan are dedicated to ensuring transfer pricing outcomes align with their value creation.[50] Actions 8, 9, and 10 call for the OECD to create a set of rules that prevent BEPS through the movement of intangibles between related parties, the transferring of risk and disproportional allocation of capital between related parties, and the engagement of transactions that would be unlikely to occur between third parties.[51]

These actions aim to ensure that actual business transactions completed by associated enterprises are present, and transfer pricing is based on economic reality rather than simple contractual arrangements within a multinational corporation.[52] This will guarantee that the allocation of risks among multiple entities within the same corporation is supported by actual decision-making.[53]

The plan seeks to reduce the impact of capital-rich, low-functioning entities in BEPS planning.[54] It will ensure that premium returns are only allocated

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Court-Invalidates-Section-482-Regulation-on-Administrative-Law-Grounds-08-19-2015/ [https://perma.cc/S7H3-6VXY] (explaining that *Altera Corp v. Commissioner* is one of many examples of the tax court invalidating regulations under I.R.C. Section 482).

[44] *See* Sheppard, *supra* note 13.

[45] KLASSEN, *supra* note 38.

[46] *Id.*

[47] *Id.*

[48] *See About BEPS and the Inclusive Framework*, *supra* note 1.

[49] *See* OECD, ALIGNING TRANSFER PRICING OUTCOMES WITH VALUE CREATION, *supra* note 37, at 9–12.

[50] *See id.*

[51] OECD, ACTION PLAN, *supra* note 16, at 19–21. Action 8 states that the OECD must "[d]evelop rules to prevent BEPS by moving intangibles among group members." *Id.* at 20. Action 9 states that they must "[d]evelop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members." *Id.* Action 10 states that the OECD must "[d]evelop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties." *Id.*

[52] *See* OECD, ALIGNING TRANSFER PRICING OUTCOMES WITH VALUE CREATION, *supra* note 37, at 13.

[53] *See id.*

[54] *See id.* at 11.

to the relevant substance, so risk-free return is only generated by capital with actual functionality.[55] This will prevent multinational corporations from reporting substantial profits to entities that have provided relatively small contributions.[56] The plan further regulates the transfer of intangibles.[57] For the purposes of these actions, intangibles are non-physical, non-financial assets that may be used for commercial purposes, and would normally be purchased when transferred between unrelated parties.[58] The returns received from intangibles will accrue to the entities that carry out the actual process of value creation rather than naturally accruing to the legal owner of the intangibles.[59]

The ultimate goal for the OECD and G20 nations is to ensure the arrangements are determined and the pricing takes into account the actual contributions of the involved parties.[60] This will require companies to keep track of the accurate delineation of intercompany transactions, transactions involving intangibles, and cost contribution arrangements.[61] In Actions 8 through 10 of the OECD's BEPS Project, the OECD attempts to confirm transfer pricing outcomes are in line with value creation.[62] However, some academics believe this vague terminology diminishes the value of the BEPS Project.[63] In order to ensure that transfer prices are fair, the OECD seeks to apply the arm's length principle to the transactions occurring within a multinational corporation.[64] In effect, the OECD aims to equate the transactions within a multinational corporation to the behavior of unrelated parties under similar circumstances.[65]

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[55] *See id.* at 13.

[56] *See id.*

[57] *BEPS Action Plan: Action 8—Transfer Pricing and Intangibles,* PWC, http://www.pwc.com/gx/en/services/tax/tax-policy-administration/beps/transfer-pricing-and-intangibles.html [https://perma.cc/JA2M-L8RE] (explaining how accrual from intangibles will be determined for purposes of Action 8 of the BEPS plan).

[58] *OECD Issues Final Guidance on Transfer Pricing for Intangibles Under BEPS Action 8*, EY (Oct. 13, 2015), http://www.ey.com/gl/en/services/tax/international-tax/alert--oecd-issues-final-guidance-on-transfer-pricing-for-intangibles-under-beps-action-8 [https://perma.cc/SXR9-LQCA].

[59] *Id.*

[60] *See id.*

[61] *See id.*

[62] *See* OECD, ALIGNING TRANSFER PRICING OUTCOMES WITH VALUE CREATION, *supra* note 37, at 9–12 (detailing the overall plan for Actions 8 through 10).

[63] *See* Herman B. Bouma, *The OECD's BEPS Project: The Emperor Has No Clothes*, BLOOMBERG (Jan. 8, 2016), http://www.bna.com/oecds-beps-project-n57982065958/ [https://perma.cc/G2ZJ-RYTL] (arguing that the lack of strong definitions throughout the BEPS Project will lead to limited results).

[64] *See* PWC, ALIGNING TRANSFER PRICING OUTCOMES WITH VALUE CREATION—REVISED CHAPTERS I, II, VI, AND VII OF THE OECD TRANSFER PRICING GUIDELINES 2 (2015), http://www.pwc.com/gx/en/services/tax/newsletters/tax-controversy-dispute-resolution/aligning-transfer-pricing-outcomes-with-value-creation.html [https://perma.cc/3D5S-35UJ].

[65] *See id.*

II. Discussion

A number of multinational corporations utilize BEPS strategies by moving profits across borders where they will be taxed at a more favorable rate.[66] This strategy deprives national governments of the proper tax bill owed and makes it more difficult for smaller businesses to compete.[67] The BEPS action plan aims to reestablish the integrity of the corporate income tax system, while promoting fairness and competition.[68]

Creating a proposal that is appealing to all nations is extremely difficult, particularly because the issue involves competition between these countries to offer tax breaks in order to attract businesses.[69] Systems that exempt certain foreign income, even if it has not been taxed abroad, prevent countries from taxing the income of the multinational enterprises earned globally.[70]

A. OECD's Primary Transfer Pricing Actions

The OECD is currently trying to resolve a number of issues to close the door on BEPS.[71] One of the primary efforts of the OECD entails clarifying and establishing stronger transfer pricing rules regarding the sale of intangibles.[72] Actions 8 through 10 deal with the issues created by intangibles, capital, and high-risk transactions.[73] These actions seek to align transfer pricing outcomes with their coinciding value creation, rather than allowing multinational corporations to report profits where value creation did not truly occur.[74]

The spread of the digital economy has made it more difficult to keep track of value creation and ensure proper taxation.[75] With digital services, intellectual property, and other intangibles being used to generate revenue, tax administrations are faced with the challenge of determining where that income is really being generated.[76] The digital economy raises questions about how value

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[66] *See* Love, *supra* note 32.

[67] *See id.*

[68] *See BEPS Explained*, *supra* note 5.

[69] BEPS Monitoring Group, Overall Evaluation of the G20/OECD Base Erosion and Profit Shifting (BEPS) Project 3, http://www.ictd.ac/images/files/General_Evaluation.pdf [https://perma.cc/27J8-GZW9] (discussing the impact that competitiveness among countries has on creating effective international plans).

[70] *Id.* at 4.

[71] *See* OECD, Addressing Base Erosion and Profit Shifting 5 (2013), http://www.oecd-ilibrary.org/docserver/download/2313151e.pdf?expires=1490117622&id=id&accname=ocid195113&checksum=872163C3A24B93C08C6D12BC08CF78B9 [https://perma.cc/B4VG-CHBR] [hereinafter OECD, Addressing Base Erosion and Profit Shifting] (describing the entire BEPS plan).

[72] *See id.* at 84.

[73] *See* OECD, Action Plan, *supra* note 16, at 49.

[74] *See* OECD, Aligning Transfer Pricing Outcomes with Value Creation, *supra* note 37, at 9–12.

[75] *See* OECD, Action Plan, *supra* note 16, at 10.

[76] *See id.* at 7–11.

is added and profits are made, and how the concepts of source and residence of income should be applied for tax purposes.[77] In order to determine how current rules should be adapted to best prevent BEPS, multinational enterprises' use of the digital economy must be closely examined to understand how exactly they add value and profit.[78] Actions 8 through 10 of the OECD's BEPS plan are aimed at ensuring that transfer price outcomes coincide with their actual value creation.[79]

Action 8 specifically aims to eliminate BEPS by moving intangibles.[80] To do this, the OECD plans to create a clear definition of intangibles, which will then allow them to ensure that the profits associated with those intangibles are appropriately allocated.[81] Further, specific transfer pricing rules will be developed for hard-to-value intangibles.[82] Hard-to-value intangibles are intangibles with a highly uncertain value at the time of transfer.[83] Hard-to-value intangibles are often created in early in the process of development for new commodities and may require significant additional research and funding before the true value may be determined.[84] This approach will check whether the taxpayer appropriately accounted for reasonably foreseeable developments, and if the proper forecasts were used in the determination of the transfer price of a hard-to-value intangible.[85]

Action 9 aims to prevent BEPS through the transfer of risks or allocation of excessive capital to subsidiaries of a multinational corporation.[86] This measure will require that multinational corporations report returns that are aligned with the proper value creation.[87] This will ensure that multinational

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[77] *Id.* at 10.

[78] *See id.*

[79] *See id.* at 20.

[80] *Id.*

[81] *Id.*

[82] *OECD Issues Final Guidance on Transfer Pricing for Intangibles Under BEPS Action 8*, *supra* note 58.

[83] *Id.* ("HTVIs are defined as 'intangibles or rights in intangibles for which, at the time of their transfer between associated enterprises, (i) no reliable comparables exist; and (ii) at the time the transaction[s] was entered into, the projections of future cash flows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible are highly uncertain, making it difficult to predict the level of ultimate success of the intangible at the time of transfer.'") (alteration in original).

[84] GRANT THORNTON, BEPS ACTION 8: HARD-TO-VALUE INTANGIBLES (HTVIS) 3 (2015), https://www.grantthornton.ie/globalassets/1.-member-firms/global/services/tax-pdfs/13.-beps-action-8---hard-to-value-intangibles-htvis-june-2015.pdf [https://perma.cc/7SL8-354R].

[85] *OECD Releases Final Reports on BEPS Action Plan,* EY (Oct. 6, 2015), http://www.ey.com/GL/en/Services/Tax/International-Tax/Alert--OECD-releases-final-reports-on-BEPS-Action-Plan [https://perma.cc/W4XK-EL8B].

[86] OECD, ACTION PLAN, *supra* note 16, at 20.

[87] *Id.*

corporations only allocate risks and capital to entities that are proportional to their actual contributions.[88]

Action 10 aims to prevent multinational corporations from engaging in high-risk transactions that other third parties would be unlikely to engage in.[89] The action seeks to apply the arm's length transaction principal to transfers between different entities within a multinational corporation.[90] To do this, the circumstances surrounding transactions must be examined so that reports of profits are aligned with value creation.[91] Further, the application of transfer pricing methods within the context of global value chains of multinational corporations must be clarified.[92] Action 10 requires strong correlations between profit allocation factors and the actual creation of value, to ensure that transactions within a multinational corporation are consistent with the arm's length principle.[93]

B. Other OECD Transfer Pricing Actions

In addition to the direct aim of Actions 8, 9, and 10 of the OECD's BEPS plan, other actions play more indirect roles in combatting transfer pricing.[94] In particular, Action 1 addresses the need to adjust taxation so that it can be readily applied to the digital economy.[95]

Action 7 aims to prevent multinational corporations from improperly reporting their permanent establishment status.[96] Tax administrations must determine whether actions that were previously considered preparatory should now be considered significant in the digital economy.[97] Additionally, the term "permanent establishment" may need to be adjusted to take into consideration transactions that can be seen as artificial transfers within a multinational corporation.[98] The OECD proposed several changes to the definition of permanent establishment in a 2015 report on Action 7.[99] The acceptance of these changes

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[88] *Id.*

[89] *Id.*

[90] *See id.* at 19–20.

[91] *See* OECD, ALIGNING TRANSFER PRICING OUTCOMES WITH VALUE CREATION, *supra* note 37, at 9–12.

[92] *See* OECD, ACTION PLAN, *supra* note 16, at 19–20.

[93] DELOITTE, BEPS ACTION 10: USE OF PROFIT SPLITS IN THE CONTEXT OF GLOBAL VALUE CHAINS 2 (2015), http://www2.deloitte.com/content/dam/Deloitte/ie/Documents/Tax/BEPS%20Action%2010%20-%20Scope%20of%20Further%20Work%20on%20Profit%20Splits%20-%20October%202015.pdf [https://perma.cc/UCY9-6XKH].

[94] *See* OECD, ACTION PLAN, *supra* note 16, at 14–24.

[95] *Id.* at 14.

[96] *Id.* at 19.

[97] *See id.* at 14–24.

[98] *Id.*

[99] *See generally* OECD, BEPS ACTION 7: PREVENTING THE ARTIFICIAL AVOIDANCE OF PE STATUS (2015), http://www.oecd.org/tax/treaties/revised-discussion-draft-beps-action-7-pe-status.pdf

means a corporation will no longer be required to conclude contracts in a given country in order for that country to be considered its permanent establishment.[100]

Further, soliciting orders or obtaining offers to enter into standard-form contracts from a country may be enough for that country to be considered a permanent establishment, even if no negotiation takes place there.[101] Finally, certain exemptions from permanent establishment status may be eliminated for certain foreign entities, depending on how central the relevant activities of the foreign entity are to its business.[102]

While most actions of the BEPS plan aim to actively address the issues, Action 11 seeks to more effectively measure the impacts of BEPS.[103] This action will allow tax administrations to "monitor and evaluate the effectiveness" of the strategies they utilize to prevent BEPS.[104] In order to accomplish this, an economic analysis must be created to measure the impact of BEPS through existing data, which will allow tax administrations to determine the appropriate actions to address it, as well as allow them to identify what other relevant data should be collected.[105]

Action 13 addresses the need for better transfer pricing documentation.[106] The OECD and participating governments are working to establish documentation requirements in an effort to enforce compliance while also acquiring information that will allow them to better understand transfer pricing.[107] Country-by-country reporting was a specific mandate by the G20 leaders in the effort to limit BEPS.[108] Requiring country-by-country reporting is essential for tracking where economic activities occur and ensuring that the multinational corporations are taxed where the value is created.[109]

However, country-by-country reporting is only required for those multinational enterprises with over seven hundred and fifty million euros of revenue

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[https://perma.cc/K254-BKKS] (explaining the need to update the definition of permanent establishment).

[100] OECD, PREVENTING THE ARTIFICIAL AVOIDANCE OF PERMANENT ESTABLISHMENT STATUS, ACTION 7—2015 FINAL REPORT (July 4, 2016), http://www.oecd-ilibrary.org/docserver/download/2315341e.pdf?expires=1494867271&id=id&accname=guest&checksum=0B6FAF5C3AF60CC1CAF65BF93383D6C4 [https://perma.cc/DWZ8-HJ2M]; *OECD Releases Proposed Changes to Permanent Establishment Rules*, OSLER (May 20, 2015), https://www.osler.com/en/resources/regulations/2015/oecd-releases-proposed-changes-to-permanent-establ [https://perma.cc/RF2Z-2ZXF] (detailing how permanent establishments are determined);

[101] *See OECD Releases Proposed Changes to Permanent Establishment Rules*, *supra* note 100.

[102] *Id.*

[103] *See* OECD, ACTION PLAN, *supra* note 16, at 21–22.

[104] *Id.*

[105] *Id.*

[106] *See id.* at 23.

[107] OECD, ADDRESSING BASE EROSION AND PROFIT SHIFTING, *supra* note 71, Annex D at 84.

[108] BEPS MONITORING GROUP, *supra* note 69, at 5.

[109] *Id.*

in the preceding fiscal year, or a domestic currency equivalent.[110] This high threshold is projected to except eighty-five to ninety percent of multinational corporations from mandatory reporting.[111] Despite these exclusions, the multinational corporations that will be required to file account for ninety percent of international corporate revenue.[112] For these reasons, the threshold strikes a balance between the difficulty of ensuring complete reporting and the benefits of tax collection to the governments.[113]

The OECD has also established safe harbor provisions in order to resolve less-contentious transfer pricing issues quickly, which allows for greater focus on larger scale matters regarding BEPS.[114] Safe harbors decrease administrative costs, create clearer rules for taxpayers and tax administrations alike, and reduce the possibility of litigation in many cases.[115] Safe harbor provisions aim to accomplish these goals by substituting simplified obligations for the general transfer pricing rules in the jurisdiction.[116]

For example, a safe harbor provision may exclude certain taxpayers and transactions from transfer pricing regulations that would otherwise apply.[117] In particular, these provisions target smaller taxpayers and less intricate dealings.[118] This eases the burden on eligible taxpayers, as it provides them with a level of certainty that their transfer prices will be accepted as long as they are in compliance.[119] Further, safe harbors allow developing countries in particular to optimize their limited resources in their effort to limit transfer pricing issues.[120]

C. Transfer Pricing Regulation Difficulties

The IRS has attempted to establish regulations to limit the ability of multinational corporations to successfully use transfer pricing to shift profits and

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[110] OECD, ACTION 13: GUIDANCE ON THE IMPLEMENTATION OF TRANSFER PRICING DOCUMENTATION AND COUNTRY-BY-COUNTRY REPORTING 4 (2015), http://www.oecd.org/ctp/beps-action-13-guidance-implementation-tp-documentation-cbc-reporting.pdf [https://perma.cc/YLR9-XFKP] [hereinafter OECD, ACTION 13] (describing the parameters that must be met to require country-by-country reporting).

[111] *Id.*

[112] *Id.*

[113] *Id.*

[114] *See* OECD, ADDRESSING BASE EROSION AND PROFIT SHIFTING, *supra* note 71.

[115] Krishen Mehta, *Comments for OECD on Transfer Pricing and Safe Harbors*, OECD, http://www.oecd.org/ctp/transfer-pricing/48931102.pdf [https://perma.cc/4VFR-RKET].

[116] *See* OECD, REVISED SECTION E ON SAFE HARBOURS IN CHAPTER IV OF THE TRANSFER PRICING GUIDELINES 4 (2013), [hereinafter OECD, REVISED SECTION E], http://www.oecd.org/ctp/transfer-pricing/Revised-Section-E-Safe-Harbours-TP-Guidelines.pdf [https://perma.cc/QJC4-CW8T].

[117] *Id.*

[118] *OECD Approves the Revision of Section on Safe Harbours In The Transfer Pricing Guidelines*, OECD (May 21, 2013), http://www.oecd.org/tax/oecd-approves-revision-section-e-tp-guidelines.htm [https://perma.cc/J5PJ-6TZV] [hereinafter *OECD Approves Revision*].

[119] OECD, REVISED SECTION E, *supra* note 116, at 5.

[120] *OECD Approves Revision*, *supra* note 118.

avoid taxation.[121] I.R.C. Section 482 is specifically intended to prevent transfer pricing and limit the abilities of multinational corporations to participate in base erosion and profit shifting schemes.[122] The primary purpose of Section 482 is to ensure corporations allocate income to the proper transactions to prevent the avoidance of taxation on these transactions.[123]

Because regulations interpreting this provision have been challenged and overruled, the legislation has had limited regulatory success.[124] In the 2015 case *Altera Corp. v. Commissioner*, the United States Tax Court invalidated regulations under Section 482, which forced participants of certain cost-sharing agreements to split costs of stock-based compensation.[125]

In 2003, the IRS created a rule that required cost-sharing arrangements to include the costs of stock-based compensation plans.[126] The IRS originally ruled that requiring stock-based compensation to be considered in cost-sharing arrangements was consistent with the arm's length standard.[127] However, the

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[121] *See* Jones et al., *supra* note 43.

[122] I.R.C. § 482 (2012). Section 482 reads:

> In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses. In the case of any transfer (or license) of intangible property (within the meaning of section 936(h)(3)(B)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible.

Id. (alterations in original).

[123] 26 C.F.R. § 1.482-1 (2015).

[124] *See* Steven P. Hannes, *Tax Court Overturns Important Transfer Pricing Regulations*, MCDERMOTT WILL & EMERY (July 31, 2015), http://www.mwe.com/Tax-Court-Overturns-Important-Transfer-Pricing-Regulations-07-30-2015/ [https://perma.cc/R2W3-H4ZX] (arguing that the decision in *Altera Corp. v. Commissioner* limits the ability of the IRS to regulate without empirical evidence).

[125] Altera Corp. v. Comm'r, 145 T.C. 91, 133–34 (2015); Jones et al., *supra* note 43; *see* Hannes, *supra* note 124. In *Altera*, the taxpayer challenged an IRS regulation requiring participants in a cost-sharing agreement to share the cost of stock-based compensation Jones et al., *supra* note 43. The regulation was overruled because it lacked a basis in fact. *Id.* The decision of the court makes it necessary for the IRS to base its regulations on empirical evidence rather than concepts such as the arm's length principle that interpret how parties to a transaction "should behave." *Id.*

[126] *Compensatory Stock Options Under Section 482*, IRS (Oct. 20, 2003), https://www.irs.gov/irb/2003-42_IRB/ar07.html [https://perma.cc/8M4R-88ZM].

[127] *Id.* While I.R.C. Section 482 does not explicitly state the arm's length principle should be applied, it is generally accepted that the arm's length principle should be read into the rule. INTERNAL REVENUE SERV., LB&I INTERNATIONAL PRACTICE SERVICE TRANSACTION UNIT 3 (2013), https://www.irs.gov/pub/int_practice_units/ISI9422_09_06.PDF [https://perma.cc/SJ7Z-YXSH]. Further, the arbitrary and capricious standard examines whether the original regulation in this instance was made on unreasonable grounds and without any proper consideration for the circumstances. Lawrence D. Rosenberg & Richard M. Re, *Basic Legal Doctrines Frequently Arising in the D.C. Circuit* (Apr. 20, 2012), http://www.americanbar.org/content/dam/aba/administrative/litigation/materials/sac_2012/34-

ruling of the IRS was overturned in *Altera*, where the court found the arm's length standard did not apply.[128] The case involved the IRS issuing notices of deficiency to Altera for their failure to properly allocate income in accordance with cost-sharing regulations.[129] The IRS stated that in order to comply with the regulations under Section 482 and achieve an arm's length result, taxpayers must share stock-based compensation costs in qualified cost-sharing agreements.[130] However, this rule was challenged and overturned by the court, which held that the IRS must show relevant evidence to justify such a rule.[131] The court found that the regulation was arbitrary and capricious, and that there was no sufficient purpose for the regulation.[132] *Altera* was the first time the Tax Court used the arbitrary and capricious standard when considering IRS regulations.[133]

The decision in *Altera* suggests that the IRS may not regulate transfer pricing transactions under the arm's length standard unless it can prove that those regulations accurately reflect how unrelated parties would act in a similar transaction.[134] This decision undid some of the efforts of the IRS to regulate transfer pricing, and gives taxpayers a precedent on which to base future arguments against IRS regulations that fail to effectively apply the arm's length transaction principal.[135]

The application of the arbitrary and capricious standard opens the door for other taxpayers to challenge IRS regulations more frequently.[136] In the past, the IRS has not been careful to provide the necessary evidence required under the arbitrary and capricious standard and may be at risk of facing more challenges to its regulations.[137] The IRS now must provide empirical data to justify regulations that are based on factual determinations.[138] Ultimately, the IRS

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basic_legal_doctrines.authcheckdam.pdf [https://perma.cc/6MFS-ZPCX]. In this case, the Tax Court found that the Internal Revenue Service (IRS) had not provided adequate empirical evidence to justify the regulation, but rather it had used its own opinion on how it believed unrelated parties should act under the circumstances. *Altera*, 145 T.C. at 133.

[128] *Altera*, 145 T.C. at 133.

[129] *Id.* at 94.

[130] Jones et al., *supra* note 43.

[131] Eric Kroh, Altera *Tax Court Win Reveals Flawed IRS Rule-Making*, LAW360 (July 28, 2015, 5:54 PM), http://www.law360.com/articles/684223/altera-tax-court-win-reveals-flawed-irs-rule-making [https://perma.cc/99XR-9R9R]. The arbitrary and capricious standard is a legal ruling where a rule or regulation is invalidated because it was made on unreasonable grounds without proper consideration of circumstances. Rosenberg & Re, *supra* note 127.

[132] Kroh, *supra* note 131.

[133] *Id.*

[134] Hannes, *supra* note 124.

[135] *See* Jones et al., *supra* note 43.

[136] *See id.*

[137] Kroh, *supra* note 131.

[138] Andrew L. Howlett et al., *Tax Court in Altera Invalidates the Cost Sharing Regulations Provision Governing Stock-Based Compensation: The Treasury Failed to Engage in 'Reasoned Decision*

cannot create regulations based on how they believe multinational corporations should act if there is no fact-based evidence to show they actually behave in that manner.[139]

D. First Efforts to Implement Changes

In 2016, the OECD and some participating jurisdictions began to move past the preliminary planning phase of the BEPS Project and changes were implemented.[140] To assist with effective implementation, the OECD has developed a multilateral instrument that will allow existing bilateral treaties to quickly implement the tax treaty measures developed throughout the BEPS Project.[141] Ideally, to allow the plan to go as smoothly as possible, the multilateral instrument will be signed by most of the participating jurisdictions.[142] The multilateral instrument will become effective once five countries have agreed to implement it and it will only apply to tax treaties where all parties have agreed to utilize the multilateral instrument and those parties have been given enough time to fully understand the effects.[143]

In addition to the development of the multilateral instrument, a number of countries have developed and implemented legal and administrative frameworks to prepare for country-by-country reporting.[144] Country-by-country reporting requires multinational corporations that generate more than a certain amount of revenue to file a report regarding how income has been allocated among various jurisdictions, taxes paid in those jurisdictions, and where economic activities have occurred among those various tax jurisdictions.[145] The exchange of country-by-country reports will begin by mid-2018.[146] While

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making' as Required by the APA, BNA (Sept. 11, 2015), http://www.bna.com/tax-court-altera-n17179935922 [https://perma.cc/9YLH-XREY].

139 *See* Hannes, *supra* note 124.

140 *See* ERNST & YOUNG, *supra* note 2, at 14–15.

141 *OECD Releases Multilateral Instrument to Modify Bilateral Tax Treaties Under BEPS Action 15*, EY: GLOBAL TAX ALERT (Nov. 25, 2016), http://www.ey.com/gl/en/services/tax/international-tax/alert--oecd-releases-multilateral-instrument-to-modify-bilateral-tax-treaties-under-beps-action-15 [https://perma.cc/B5HP-L9CR] [hereinafter *Multilateral Instrument*].

142 PWC, MULTILATERAL INSTRUMENT TO IMPLEMENT BEPS TREATY-RELATED RECOMMENDATIONS ALMOST FINAL (2016), https://www.pwc.com/cz/cs/danove-sluzby/danova-politika/assets/pwc-multilateral-instrument-to-implement-beps-recommendations.pdf [https://perma.cc/NG6G-6B97].

143 *Multilateral Instrumen*t, *supra* note 141, at 3.

144 B. Bawono Kristiaji et al., *Indonesia Adopts CbCR and New Transfer Pricing Documentation Requirements*, TP WEEK (Jan. 12, 2017), http://www.tpweek.com/Article/3652379/Indonesia-adopts-CbCR-and-new-transfer-pricing-documentation-requirements.html [https://perma.cc/8CFB-E96P].

145 *Id.*

146 Kevin A. Bell, *Countries' Global Tax, Profit Reporting Under Review*, BNA: TRANSFER PRICING REP. (Feb. 2, 2017), https://www.bna.com/countries-global-tax-n57982083208/ [https://perma.cc/EB23-WSR5].

these efforts are a step in the right direction, there is still a lot of work to be done surrounding BEPS.[147]

III. Analysis

A. Impact of BEPS

BEPS is a multinational issue that must be handled through the cooperation of all nations affected.[148] Research has estimated that between four and ten percent of global corporate income tax revenue is lost annually due to BEPS.[149] The issue has brought the OECD and the G20 countries together to work on a level playing field.[150] Further, over a dozen developing countries are working toward a solution, while more than eighty non-OECD, non-G20 jurisdictions offered opinions on the subject.[151] The cooperation of the G20 and the OECD demonstrates commitment to a common goal.[152] The BEPS Project aims to tax profits where they are generated, while providing corporations with more certainty regarding the international tax rules.[153] Because BEPS is a global problem, the creation of the BEPS plan has taken into account the opinions and ideas of various parties, from the OECD and G20 countries to dozens of developing countries and over eighty non-OECD, non-G20 jurisdictions.[154]

B. Effects of Actions 8, 9, and 10

The OECD and the G20 nations have begun to solve the issue of BEPS primarily by addressing the cost of intangibles, risks, capital, and high-risk transactions and ensuring they are reported in the proper jurisdiction.[155] Action 8 of the BEPS Project aims to simplify identification of intangibles, which will inherently make it easier to regulate their transfer.[156] To do this, the OECD broadly defines intangibles as something that is not a physical asset or a finan-

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[147] *See, e.g.*, Ernst & Young, *supra* note 2, at 2 (detailing reports of the OECD action plan and explaining that further efforts must be put forth in subsequent years).

[148] *See generally* Christy Irene D. Enrile, *BEPS: A Multinational Problem Calling for a Multinational Solution*, Philstar (July 14, 2015, 12:00 AM), http://www.philstar.com/business/2015/07/14/1476602/beps-multinational-problem-calling-multinational-solution [https://perma.cc/9A3R-CW8E] (arguing that nations around the world must cooperate in order to properly address the problems created by base erosion and profit shifting).

[149] *About BEPS and the Inclusive Framework*, *supra* note 1.

[150] *Id.*

[151] *Id.*

[152] *See id.*

[153] *Id.*

[154] *Id.*

[155] *See* OECD, Action Plan, *supra* note 16, at 20–21.

[156] *See id.*

cial asset.[157] From this definition, intangibles are split into marketing intangibles and trade intangibles.[158] Being able to clearly establish what constitutes intangibles naturally makes it easier to regulate them.[159]

Even if the OECD is able to clearly define intangibles, there will still be instances in which those intangibles are hard to value.[160] To effectively understand the transfer of intangibles, the contractual terms and actual legal ownership of the intangible must be considered in light of the relationship of the transacting parties.[161] In instances where the intangibles are hard to value, enterprises may consider the anticipated benefits as a means for pricing the transaction.[162] Multinational corporations may also consider the risks posed due to the high level of uncertainty in valuing intangibles.[163] While the OECD may be able to clearly define intangibles and find mildly comparable circumstances, questions still remain on how the value of those intangibles should be determined.[164]

Action 9 will help prevent capital-rich entities from allocating excessive profits if they fail to perform economic tasks related to the transaction and do not have control over the financial risk.[165] This will help guarantee that income is allocated to the proper entities.[166]Action 10 will ensure that the affiliates of multinational corporations only engage in transactions that make financial sense and would be likely to occur between independent third parties.[167] This action provides a solid framework for treating issues concerning the various profit allocation methods.[168] The commodity transactions method may be more appropriate for instances where the transactions are centered on commodi-

[157] OECD, GUIDANCE ON TRANSFER PRICING ASPECTS OF INTANGIBLES 28 (2014), http://www.oecd-ilibrary.org/docserver/download/2314291e.pdf?expires=1491016235&id=id&accname=guest&checksum=D4DA45D00BD097142E7C4D166D34F518 [https://perma.cc/7QY5-KWYS] [hereinafter OECD, GUIDANCE ON TRANSFER PRICING] (defining "marketing intangibles" and "trade intangibles" as they are used for the purposes of the BEPS Project).

[158] *BEPS Action Plan: Action 8—Transfer Pricing and Intangibles*, *supra* note 57 (describing the necessity of a clear definition in order to properly address the issue).

[159] *See* OECD, GUIDANCE ON TRANSFER PRICING, *supra* note 157, at 28.

[160] *See id.* at 86–87.

[161] *See BEPS Action Plan: Action 8—Transfer Pricing and Intangibles*, *supra* note 57 (explaining that contracts between parties must be read in a particular manner in order to reduce complexity and effectively address issues created by the transfer of intangibles).

[162] OECD, GUIDANCE ON TRANSFER PRICING, *supra* note 157, at 86 (describing how transactions concerning hard-to-value intangibles must be dealt with so that they can properly be handled despite the complexity in their evaluations).

[163] *See id.*

[164] *See id.* (outlining the issues that still remain in transactions involving intangibles despite the OECD definitions).

[165] *See BEPS Action Plan: Action 8—Transfer Pricing and Intangibles*, *supra* note 57.

[166] *See id.*

[167] *See* OECD, ACTION PLAN, *supra* note 16, at 20.

[168] *See BEPS Action Plan: Action 8—Transfer Pricing and Intangibles*, *supra* note 57.

ties.[169] The value of low value-adding services must also be examined to determine if the profit allocation for those services is appropriate.[170]

The transactional profit split method requires that the transaction be examined to determine what constitutes unique and valuable contributions.[171] If multiple entities make unique and valuable contributions, then a profit split between those entities is appropriate.[172] The full effects of the BEPS plan will become more evident over time as the plan is fully implemented and the results may be observed.[173] For now, questions remain regarding application of the plan, creating uncertain expectations for corporations.[174] For instance, some standards implemented by the OECD differ from existing U.S. tax law and create questions for taxpayers.[175] Until it is clear how the contradicting changes will be implemented, corporations must view the results of their transactions from numerous viewpoints and contemplate various potential results.[176]

C. Issues with Country-by-Country Reporting

One major step to ensure compliance and reduce the success of BEPS strategies is to require transparency.[177] The OECD believes data collection on BEPS must be improved and more accessible.[178] Further, taxpayers should be required to provide more information on their tax planning strategies, and transfer pricing documentation requirements must be made simpler and focus more on relevant information.[179]

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[169] *See BEPS Action Plan: Action 10—Transfer Pricing and Other High-Risk Transactions*, PWC, http://www.pwc.com/gx/en/services/tax/tax-policy-administration/beps/transfer-pricing-and-other-high-risk-transactions.html [https://perma.cc/CG5P-H2U4].

[170] *See id.* Low value-adding intra-group services are defined as:

> [S]ervices performed by one or more members of a[] [Multinational Entity] group that are supportive in nature rather than being part of its core business; do not require the use of unique and valuable intangibles and do not lead to the creation of such intangibles; and do not involve the assumption or control of substantial or significant risk by the service provider and do not give rise to the creation of significant risk for the service provider . . . .

Id.

[171] *Id.*

[172] *Id.* Under the transactional profit split method, the overall net operating profits that arise from the intercompany transactions are examined. *Id.*

[173] *See* PWC, TRANSFER PRICING PERSPECTIVES: BEYOND BOUNDARIES 56, 59 (2015), http://www.pwc.com/gx/en/tax/publications/transfer-pricing/perspectives/assets/transfer-pricing-beyond-bountries.pdf [https://perma.cc/569C-KZCP].

[174] *See id.*

[175] *Id.*

[176] *Id.*

[177] *See id.* at 14 (noting that "country-by-country reporting will bring greater transparency"); OECD, ACTION PLAN, *supra* note 16, at 14.

[178] *See* OECD, ACTION PLAN, *supra* note 16, at 21.

[179] *Id.*

While country-by-country reporting will be important in addressing BEPS issues going forward, this reporting system is not without its flaws.[180] While the seven hundred and fifty million euro threshold for reporting will require corporations controlling ninety percent of the files to report, most corporations will not be required to report.[181] The threshold makes sense in the economies of the large G20 countries, but will not provide the same type of benefit in developing countries.[182]

Furthermore, the country-by-country reporting records must be made public to be most effective.[183] Critics believe corporations should be required to disclose this information to investors, stakeholders, and the general public.[184] Requiring these records to be public is necessary to restore public confidence in the international tax system.[185] Publication would allow for more comprehensive research, as it would provide critical information to national governments, international organizations, and scholars.[186] The existing data is insufficient, which makes it difficult for researchers to understand how to fully address BEPS and its related problems.[187] If these country-by-country reports are made available, researchers will have access to invaluable information.[188] Alternatively, in lieu of publication, a policy of granting limited access under special circumstances for research purposes could achieve some of these same goals.[189]

D. Issues in Developing Countries

While the United States and other G20 countries struggle to create regulations to effectively curb BEPS strategies, developing countries face an even greater challenge.[190] Developing countries may rely even more heavily on their tax revenue, but they often have rules that fail to effectively regulate BEPS issues and they lack the resources necessary to create and implement the proper rules.[191] One global accounting firm estimates that if transfer pricing issues

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[180] *See generally* BEPS MONITORING GROUP, *supra* note 69, at 5 (describing the limitations of the threshold for country-by-country reporting and the need for public records).

[181] *OECD Approves Revision*, *supra* note 118, at 4.

[182] *See* BEPS MONITORING GROUP, *supra* note 69, at 5 (describing the limitations of country-by-country reporting thresholds on less developed countries that fail to meet those standards).

[183] *See id.* at 5 (arguing that country-by-country reporting “should be public”).

[184] *Id.*

[185] *Id.*

[186] *Id.*

[187] *See id.*

[188] *Id.*

[189] *Id.*

[190] *See* OECD, ADDRESSING BASE EROSION AND PROFIT SHIFTING, *supra* note 71, at 87, box D.1.

[191] *Id.*

are properly dealt with, developing countries may collect over forty percent more in tax revenue from multinational corporations.[192]

Further, developing countries lack the resources to gather the relevant data needed to create the proper rules.[193] In some cases, the proposed solutions for BEPS are too complex and resource intensive for developing countries, considering the resources they have available.[194] Smaller economies lose out on valuable revenue needed to further development.[195]

Additionally, country-by-country reporting is only required by those multinational enterprises with annual consolidated group revenue of seven hundred and fifty million euros or more in the preceding fiscal year.[196] This high threshold for country-by-country reporting will likely limit the ability of developing countries to gather and access the data that is available to the larger G20 economies.[197] The high threshold may leave developing nations without information on multinational enterprises that are essential to them.[198] While the threshold creates a balance between the reporting burden and tax benefits for G20 governments, the benefits are experienced largely by the bigger economies.[199]

While governments in developed countries use taxes to finance aid, among other things, developing countries rely on this income to continue their economic and infrastructural progression.[200] If developing countries are able to receive the proper taxes from multinational corporations, they will be able to continue to grow and create a bigger tax base, which will allow them to become less dependent on foreign aid.[201] Thus, addressing the issue of transfer pricing in developing countries would be beneficial to both developed and developing countries.[202]

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[192] PWC, TRANSFER PRICING AND DEVELOPING COUNTRIES: FINAL REPORT 5 (2016), https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/transfer_pricing_dev_countries.pdf [https://perma.cc/3BWW-BJ7L] (report commissioned by the European Commission); ActionAid, *The BEPS Process: Failing to Deliver for Developing Countries*, at 2 (Sept. 16, 2014), http://www.francophonie.org/IMG/pdf/beps_16th_sept_2014_actionaid.pdf [https://perma.cc/9KA3-LUZA] (detailing research on transfer pricing done by PricewaterhouseCoopers).

[193] *See* ActionAid, *supra* note 192, at 6.

[194] *See id.*

[195] *See id.* at 2.

[196] OECD, ACTION 13, *supra* note 110.

[197] BEPS MONITORING GROUP, *supra* note 69, at 5.

[198] *Id.*

[199] *Id.*

[200] Angel Gurria, Opinion, *The Global Dodgers,* GUARDIAN (Nov. 26, 2008, 7:01 PM), http://www.theguardian.com/commentisfree/2008/nov/27/comment-aid-development-tax-havens [https://perma.cc/RTP4-U95D].

[201] ActionAid, *supra* note 192, at 2.

[202] *See id.*; Gurria, *supra* note 200.

E. The Value of Additional Revenue and the Arm's Length Principal

As discussed previously, the revenue losses from BEPS have been estimated at between one hundred and two hundred and forty billion dollars.[203] While these numbers may seem high at first glance, some believe their significance is overstated when considered within their context.[204] Global tax revenues amount to over twenty-three trillion dollars.[205] Taxation efforts will inevitably be unable to recapture all lost revenue.[206] If taxation efforts are able to raise another one hundred billion dollars, governments would only be adding 0.4 percent to their current tax revenue.[207] Compared to the global tax revenues and the global economy as a whole, these lost tax revenues that the OECD and G20 nations are working to retrieve may not be so significant.[208] Despite these concerns, the BEPS plan is not entirely about increasing revenue, but also about ensuring fairness in the taxation system and regaining the trust of citizens who believe they are being cheated by the system.[209]

Additional tax revenue would be significant in developing countries that are more reliant on corporate income tax revenues.[210] One unintended consequence of the BEPS action plan, however, is the tax burden that it may place on workers.[211] The combination of capital and labor allows for productivity.[212] An increase in capital leads to increased productivity, which will eventually lead to increased pay for workers.[213] When that capital is taxed more heavily, less capital will be utilized and the wages of the workers will be diminished.[214] When the effects of the BEPS plan are considered in this light, the workers in

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[203] *About BEPS and the Inclusive Framework*, *supra* note 1.

[204] Joe Harpaz, *Many Companies Not Ready for Global Tax Reform,* FORBES (Oct. 6, 2015, 9:10 AM), http://www.forbes.com/sites/joeharpaz/2015/10/06/many-companies-not-ready-for-global-tax-reform/#f420a5a64807 [https://perma.cc/L9K4-RUKQ] (arguing that the data on lost revenue must be considered in terms relative to all international numbers rather than in absolute terms); Tim Worstall, *The OECD's BEPs Corporate Tax Plan Is a Complete Waste of Time and Effort, Counter Productive Even,* FORBES (Oct. 6, 2015, 10:02 AM), http://www.forbes.com/sites/timworstall/2015/10/06/the-oecds-beps-plan-is-a-complete-waste-of-time-and-effort-counter-productive-even/#2cea9ea3682e [https://perma.cc/6VJV-5L56].

[205] *See* Worstall, *supra* note 204.

[206] *See id.*

[207] *Id.*

[208] *See id.* (noting the relative insignificance of revenue from efforts to regulate BEPS compared to all global tax revenue).

[209] *OECD Presents Outputs of OECD/G20 BEPS Project for Discussion at G20 Finance Ministers Meeting, supra* note 19.

[210] *About BEPS and the Inclusive Framework*, *supra* note 1.

[211] Worstall, *supra* note 204 (describing the role that capital and labor play in tax burdens in economic terms).

[212] *Id.*

[213] *Id.*

[214] *Id.* These calculations and suggestions are hypothetical economic speculations. *See id.*

developing countries, who are among the poorest people in the world, will be faced with an increased tax burden.[215]

Another significant issue in addressing the problem of BEPS is the insistence on using the arm's length principle by the United States and other countries.[216] The suggestion that transactions between different branches within a multinational corporation are freely negotiated is often false.[217] Under this system, the multinational corporations will be able to negotiate with tax administrations regarding the allocation of their tax bases throughout their multiple tax jurisdictions.[218] Even with the coming changes, the concepts utilized in allocating profits still often allow for multinational corporations to make allocation decisions at their discretion.[219] Because the arm's length principal is not truly indicative of how these transactions actually occur, the effects of new regulations on transfer pricing may still result in under-taxation or they may assess transactions in ways that do not accurately reflect the nature of the transactions.[220]

F. Issues with Creating New Regulations

While the IRS has attempted to implement regulations through interpretations and provisions of the tax code, it has faced a number of challenges.[221] In particular, the decision of the Tax Court in *Altera Corp. v. Commissioner* potentially opens the door for taxpayers to question the validity of other provisions of Section 482 that overreach.[222] Taxpayers will feel more confident challenging any other current or future regulations that they believe fail to meet the proper promulgation standards.[223] The IRS can no longer arbitrarily create regulations; instead, it must provide efficient data to justify the regulations.[224]

The ruling in *Altera* is not only significant in the context of transfer pricing regulations, but also as it relates to the general validity of tax regulations.[225] In the future, the IRS will face more scrutiny in its creation of new

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[215] *Id.*

[216] *See* BEPS MONITORING GROUP, *supra* note 69.

[217] *Id.* While the concept of the arm's length principle is used by the OECD when designing rules, corporations typically do not utilize the concept in real transactions. *See id.*

[218] *Id.*

[219] *Id.* The changes that will be created by the BEPS Project will not solve all issues, as companies can still manipulate their books in other ways. *Id.*

[220] *Id.*

[221] *See* Jones et al., *supra* note 43.

[222] *See id.*

[223] *See id.*

[224] *See* Hannes, *supra* note 124.

[225] *See* Jones et al., *supra* note 43 (suggesting that the ruling in *Altera* was significant in that it limited the powers of the IRS to create legislation).

regulations, which will effectively limit its power.[226] Any regulations previously created based on this approach may now be in serious jeopardy of being overturned because the decision casts doubt on the promulgation process for many current regulations still in effect.[227]

The IRS will now be required to gather relevant facts and data to support the results created by new regulations.[228] The IRS cannot make regulations based on the way it believes multinational corporations should act; rather, regulations must be backed by sufficient empirical evidence showing how unrelated parties actually behave in similar situations.[229] Even though I.R.C Section 482 does not explicitly require interpretation in accordance with the arm's length principle, U.S. courts and the comments of the U.S. Treasury have consistently stated that the principle is incorporated within the statute.[230] Despite its limitation of the IRS's ability to regulate BEPS, the *Altera* decision is ultimately favorable for taxpayers because it forces the IRS to provide empirical data to justify its regulations.[231]

G. Use of the Multilateral Instrument

In late 2016, the OECD finalized a multilateral instrument to assist in the implementation of tax treaty measures in participating jurisdictions.[232] While ceremonial signing of the instrument is not expected until June 2017, the finalization of the instrument itself is a key step in the right direction.[233] This instrument is essential as it will allow any country that signs on to update all of its treaties simultaneously, rather than having to re-negotiate each one individually.[234] Because the multilateral instrument must be flexible enough to amend over three thousand treaties with various differences, some believe the instrument is obtuse.[235] While the multilateral instrument has the power to amend all of these treaties, effects may be slowed by the fact that countries may select which of their treaties will be covered and those treaties will only be amended if all other parties to the treaties also select them to be covered.[236]

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[226] *See id.*
[227] *See id.*
[228] *See id.*
[229] *See* Hannes, *supra* note 124.
[230] *See id.*
[231] *See id.*
[232] *Multilateral Instrument*, *supra* note 141, at 2–3.
[233] *See id.*
[234] Tony Frost et al., *BEPS Big Bang Complexity for Income Tax Treatites—On a Delayed Fuse,* LEXOLOGY (Feb. 1, 2017), http://www.lexology.com/library/detail.aspx?g=35221c1d-2eea-4f1e-b9b1-f15711347fa9 [https://perma.cc/5J67-7QT2].
[235] *Id.*
[236] *See id.*

H. Safe Harbors

The creation of safe harbor provisions produces a number of benefits.[237] Safe harbors are able to be either exclude transactions from the scope of transfer pricing rules if they surpass a certain threshold or apply simplified rules where the transaction price or profit falls within a certain range.[238] Safe harbors make it easier for taxpayers to comply and reduce the compliance cost for eligible taxpayers.[239] In many instances, it would be too expensive to apply the arm's length principle considering the amount of revenue that would be brought in by the taxpayer.[240] The excessive cost of the arm's length principle makes the use of a safe harbor provision the best option.[241]

The use of a safe harbor provision also provides taxpayers with a degree of certainty that their prices and transactions will be accepted by the tax administrations.[242] This allows taxpayers to have their prices approved with a limited audit, or even without an audit, if they are simply able to show they fall within the safe harbor provision.[243]

In addition to making it easier for the taxpayers to comply and reducing compliance costs, safe harbors simplify the administrative process for tax administrations.[244] Safe harbors limit the amount of resources that tax administrators have to devote to transfer pricing issues, and allow them to redirect those resources elsewhere.[245] Tax administrations still need to ensure the taxpayers actually fall within the safe harbor, but beyond that, minimal further examination is required.[246] This administrative efficiency is particularly useful in low risk situations, as the tax administrators are not forced to dedicate a disproportionate amount of resources to the issue.[247] The newly saved resources can then be dedicated to matters where they may be put to better use.[248] These safe harbors may also increase compliance among taxpayers and smaller taxpaying entities that otherwise may have escaped examination.[249]

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[237] *See* OECD, *Revised Section E*, *supra* note 116, at 5 (arguing that safe harbors create an easier system by limiting requirements and allowing for easier compliance).

[238] ROBERT T. COLE & WILLIAM H. BYRNES, PRACTICAL GUIDE TO U.S. TRANSFER PRICING § 2.08 (3d ed. 2006).

[239] *See* OECD, *Revised Section E*, *supra* note 116, at 4.

[240] *See id.*

[241] *See id.* In many cases, it is not realistic to use the arm's length principle because the cost of application outweighs the benefits of additional tax revenue. *See id.*

[242] *See id.*

[243] *Id.*

[244] *See id.*

[245] *See id.*

[246] *See id.* The simplicity presented by safe harbors would lower costs by the tax administrators and allow valuable resources to be devoted to areas of need. *See id.*

[247] *See id.*

[248] *See id.*

[249] *Id.*

Despite these numerous benefits, the implementation of safe harbor provisions is not without its faults.[250] For instance, safe harbors create a system that accepts looser compliance with the arm's length principle in exchange for more efficiency.[251] Safe harbors also create questions regarding the equity and uniformity of the tax system.[252] Furthermore, if safe harbors are only adopted unilaterally, there will be a greater risk of either double taxation or double non-taxation for the multinational corporation.[253]

The potential disadvantages of straying away from the arm's length principle may be avoided by allowing taxpayers to choose between utilizing the safe harbor provision and electing to price transactions in accordance with the arm's length principle.[254] This option would allow taxpayers who believe they are reporting more income under the safe harbor provisions than they otherwise would have under the arm's length principle to use the general transfer pricing rules.[255] While this system may make more sense for the taxpayers, it creates a new issue for the tax administration.[256] The tax administrators would be faced with the issue of determining whether this system is too favorable to the taxpayer, as it would require the taxpayer to pay tax only on the lesser of the safe harbor amount and the amount consistent with the arm's length principle.[257] Countries must consider the benefits of the safe harbor against the potential loss of tax revenue.[258]

The implementation of a safe harbor further increases the risk of double taxation and non-taxation.[259] If safe harbor provisions are set at prices above or below the prices in accordance with the arm's length principle, taxpayers will be inclined to modify prices in order to avoid transfer pricing scrutiny in the safe harbor country.[260] Multinational corporations would be particularly inclined to do this in countries that impose significant penalties for understatement of tax or failure to fulfill documentation requirements.[261] By making sure they fall within the safe harbor provisions in these nations, multinational cor-

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[250] *See id.* at 6.

[251] *Id.* Creating guidelines for safe harbors that reflected the arm's length principal would create a complex system that is counterintuitive to the goal of safe harbors. *See id.*

[252] *Id.*

[253] 3 WILLIAM P. STRENG & JESWALD W. SALACUSE, INTERNATIONAL BUSINESS PLANNING § 22.01 (2017).

[254] *See* OECD, *Revised Section E*, *supra* note 116, at 6. Although giving taxpayers options may increase administrative costs, it will likely improve compliance. *See id.*

[255] *See id.*

[256] *See id.*

[257] *See id.*

[258] *See id.*

[259] *See* STRENG & SALACUSE, *supra* note 253. The use of safe harbors has risks, as some amounts that fall within safe harbors will not be properly looked at and will avoid taxation while other amounts that fall outside of the safe harbor will be taxed again. *See id.*

[260] *See* OECD, *Revised Section E*, *supra* note 116, at 7.

[261] *See id.*

porations will be able to have their transfer pricing accepted in the country without further review.[262] The safe harbor provisions could potentially result in tax avoidance as multinational corporations manipulate their income and financial statements to fall within the confines of the safe harbor.[263]

Safe harbors that allow taxpayers to report income above the amount deemed appropriate through the arm's length principle would be beneficial to the tax administration of the safe harbor country.[264] However, the tax administration of a country on the other side of the transaction may challenge the prices from the application of a safe harbor, which could potentially result in double taxation.[265]

Any benefits gained by the tax administration of the safe harbor country might only come at the expense of the tax administration of the country on the other side of the transaction.[266] The country on the other side of the transaction would have to then examine the transaction and determine whether the application of the safe harbor provision in the safe harbor country is consistent with its own tax rules.[267] In many instances, when an issue arises as a result of the safe harbor provision, it is beyond the authority of a foreign tax administration to require the levels to be reported in accordance with the arm's length principle.[268] The unilateral adoption of safe harbor provisions would likely lead to contradicting tax regulations between countries and incline the multinational corporations to report income in such a manner that would benefit one country while hurting another.[269]

In order to safeguard against such disadvantages, safe harbors should be adopted on a bilateral or multilateral basis.[270] This will prevent the benefits of one country from negatively impacting another.[271] To help ensure success in instances where countries are willing to enter into bilateral or multilateral safe harbor agreements, these countries should target a small range of acceptable results and require consistent financial reporting in all countries that are party to the agreement.[272] Further, countries may use treaties for the exchange of information to ensure proper reporting under bilateral safe harbor provisions.[273]

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[262] *See id.*

[263] *See id.* at 8. If corporations shift revenue to lower tax jurisdictions, safe harbors may ultimately result in a significant loss of tax revenue for the safe harbor offeror. *Id.*

[264] *See id.*

[265] *Id.*

[266] *Id.*

[267] *See id.*

[268] *See id.*

[269] *See id.*

[270] *See id.* Adopting safe harbors on a bilateral or multilateral basis would allow nations to limit application to countries with similar issues. *Id.*

[271] *See id.*

[272] *See id.*

[273] *See id.*

I. Going Forward

The OECD plan to address BEPS will likely have a significant effect on tax evasion issues created by multinational corporations going forward, but it will not wholly solve the problem.[274] More efforts are needed to further prevent the effects of BEPS.[275] While the OECD and the G20 nations represent a large number of states, an adequate solution cannot be created using solely their perspectives.[276] In its current form, the BEPS plan will only be partially effective and will pose major problems of implementation.[277] Beyond reform, more parties must be involved so the solutions can be monitored, implemented and the relevant parties can be provided with the assistance they need to better understand their responsibilities.[278] It is clear that the BEPS plan is the first step in a process of resolving the multitude of issues surrounding the taxation of multinational corporations.[279]

CONCLUSION

The efforts put forth thus far are positive moves toward ensuring multinational corporations pay their fair share in taxes, however, transfer pricing must be regulated more closely in order to eliminate BEPS by multinational corporations. Although the efforts to prevent BEPS primarily target the multinational corporations that would provide the most revenue, the same rules must apply to all. While the intentions of the OECD are noble, the current plan will likely prove more beneficial to developed countries. Creating an effective plan to combat BEPS should not involve this type of tradeoff. While the OECD should not disproportionately burden the economies of developing nations to assist developed nations, it must strike a balance between efficiency and strict application of regulations. In instances where the additional revenue would be insignificant compared to the additional efforts required, tax administrations may find it best to create exceptions such as safe harbors.

Although not all of the loopholes will be closed, narrowing the gaps is essential to creating a more fair tax system. The BEPS plan is a positive step toward a better international tax system. If the plan is executed properly, it will be beneficial to developed and undeveloped countries alike. The BEPS plan will level the playing field for corporations, forcing them to pay their proper

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[274] *See* BEPS MONITORING GROUP, *supra* note 69, at 11.
[275] *See id.*
[276] *See id.* (arguing that accepting input from various developed and less developed nations and different international organizations would lead to a more complete agenda).
[277] *See id.*
[278] *See id.*
[279] *See id.*

share of taxes, while also ensuring that governments receive the taxes they are owed.